Office-Supreme Court, U.S.
FILED
JUL 22 1983
ALEXANDER L. STEVAS,
CLERK

No. 82-1041

In the Supreme Court of the United States

OCTOBER TERM, 1983

ESTHER C. DICKMAN, ET AL., PETITIONERS

v.

COMMISSIONER OF INTERNAL REVENUE

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE ELEVENTH CIRCUIT

BRIEF FOR THE RESPONDENT

REX E. LEE
Solicitor General

GLENN L. ARCHER, JR.
Assistant Attorney General

LAWRENCE G. WALLACE
Deputy Solicitor General

HARRIET S. SHAPIRO
Assistant to the Solicitor General

MICHAEL L. PAUP
JONATHAN S. COHEN
FARLEY P. KATZ
Attorneys

Department of Justice
Washington, D.C. 20530
(202) 633-2217

QUESTION PRESENTED

Whether intra-family interest-free loans, payable on demand or after a term, result in taxable gifts of the right to use money.

TABLE OF CONTENTS

	Page
Opinions below	1
Jurisdiction	1
Statutory provisions involved	2
Statement	3
Summary of argument	5
Argument:	
I. The gift tax reaches any gratuitous transfer of any interest in property:	
A. The statute and the regulations	7
B. Application to interest-free loans	15
II. The holding below effectuates the congressional policy underlying the gift tax statute	19
III. The holding below is consistent with decisional law concerning related situations:	
A. Term loan	22
B. Income tax	29
IV. The holding below creates neither administrative problems nor anomalies in the tax law:	
A. Insignificant loans	34
B. Valuation	37
C. Double counting	39
D. Loans versus outright gifts	40
E. Loans to charitable organizations	41
Conclusion	43

TABLE OF AUTHORITIES

Cases:

Abbott v. *United States*, 74-2 U.S. Tax Cas. (CCH) ¶ 13,040	16
Allen v. *Commissioner*, 57 T.C. 12	16

Cases—Continued: Page

Automobile Club v. *Commissioner*, 353 U.S. 180.... 15
Baker v. *Commissioner*, 677 F.2d 11, aff'g 75 T.C. 166 ..... 29, 31, 32
Barer v. *Goldberg*, 20 Wash. App. 472, 582 P.2d 868 26
Beaton v. *Commissioner*, 664 F.2d 315, aff'g 40 T.C.M. (CCH) 1324 ..... 29, 32
Berkman v. *Commissioner*, 38 T.C.M. (CCH) 183.. 22, 37
Blackburn v. *Commissioner*, 20 T.C. 204 ..... 22, 37
Boston & Lowell R.R. v. *Salem & Lowell R.R.*, 68 Mass. (2 Gray) 1 11
Catalano, Inc. v. *Target Sales, Inc.*, 446 U.S. 643.... 18
Challenge Manufacturing Co. v. *Commissioner*, 37 T.C. 650 31-32
Chandler v. *Commissioner*, 119 F.2d 623 31
Cochran v. *Cochran*, 133 Wash. 415, 233 P. 918.... 26
Commissioner v. *Beck's Estate*, 129 F.2d 243..... 30
Commissioner v. *Duberstein*, 363 U.S. 278 30
Commissioner v. *Glenshaw Glass Co.*, 348 U.S. 426 ..... 11, 31
Commissioner v. *Greenspun*, 670 F.2d 123, aff'g 72 T.C. 931 ..... 29, 31, 32, 33
Commissioner v. *LoBue*, 351 U.S. 243 30
Commissioner v. *Wemyss*, 324 U.S. 303 ..... 10, 11, 30
Covina Manor, Inc. v. *Hatch*, 133 Cal. App. 2d Supp. 790, 284 P.2d 580 17
Creel v. *Commissioner*, 72 T.C. 1173, aff'd, 649 F.2d 1133 29
Crown v. *Commissioner*, 67 T.C. 1060, non acq., 1978-2 Cum. Bull. 3, aff'd, 585 F.2d 234 ..... *passim*
Dean v. *Commissioner*, 35 T.C. 1083, non acq., 1973-1 Cum. Bull. 4 ..... 13, 14, 29, 30, 31, 32
Deputy v. *Du Pont*, 308 U.S. 488 9
Dixon v. *United States*, 381 U.S. 68 15
Frueauff v. *Commissioner*, 30 B.T.A. 449 32
Galt v. *Commissioner*, 216 F.2d 41, cert. denied, 348 U.S. 951 38
Gardner v. *Commissioner*, 613 F.2d 160 31
Hardee v. *United States*, No. 84-79 (Fed. Cir. May 11, 1982), rev'g, No. 84-79 (Ct. Cl. July 6, 1982) 31, 32

Cases—Continued: Page

Harris v. *Commissioner*, 340 U.S. 106 ..... 19, 35
Helvering v. *Clifford*, 309 U.S. 331 .....11, 21, 31
Helvering v. *Hallock*, 309 U.S. 106 ..... 14, 15
Helvering v. *Wilshire Oil Co.*, 308 U.S. 90 15
Jewett v. *Commissioner*, 455 U.S. 305 10
Johnson v. *United States*, 254 F. Supp. 73.....13, 14, 21, 25, 39
Joseph Lupowitz Sons, Inc. v. *Commissioner*, 497 F.2d 862 29
Lang, Estate of v. *Commissioner*, 613 F.2d 770.... 26
Martin v. *Commissioner*, 649 F.2d 1133, aff'g 39 T.C.M. (CCH) 531 .....18, 29, 32
Mason v. *United States*, 513 F.2d 25 .....22-23, 37
Orr v. *United States*, 343 F.2d 553 17
Park v. *Commissioner*, 686 F.2d 408, aff'g 40 T.C.M. (CCH) 1228 .....29, 31, 32
Passailaigue v. *United States*, 224 F. Supp. 682.... 16, 17
Public Service Co. v. *Voudomas*, 84 N.H. 387, 151 A. 81 17
Putnam v. *Commissioner*, 352 U.S. 82 25
Robinette v. *Helvering*, 318 U.S. 184 10
Ruhl v. *Perry*, 390 So. 2d 353 26
Saunders v. *United States*, 294 F. Supp. 1276, rev'd on other grounds, 450 F.2d 1047 29
Schnug v. *Schnug*, 203 Kan. 380, 454 P.2d 474.... 26
Smith v. *Commissioner*, 41 T.C.M. (CCH) 1427.... 37-38
Smith v. *Shaughnessy*, 318 U.S. 176 .....10, 19, 38
Stanford, Estate of v. *Commissioner*, 308 U.S. 39.. 19
Stoudenmire v. *Florida Loan Co.*, 117 So. 2d 500.... 26
Sullivan v. *Commissioner*, 16 T.C. 228, acq., 1951-1 Cum. Bull. 3 16
Suttle v. *Commissioner*, 625 F.2d 1127 ..... 29, 32
Threlfall v. *United States*, 302 F .Supp. 1114..... 16, 42
Thriftmart, Inc. v. *Commissioner*, 59 T.C. 598, acq., 1973-2 Cum. Bull. 4, remanded on other issues, No. 73-3108 (9th Cir. Dec. 10, 1975)..... 16, 17
Trowbridge v. *Commissioner*, 41 T.C.M. (CCH) 1302 29
United States v. *Smoot Sand & Gravel Corp.*, 248 F.2d 822 17

Cases—Continued: Page

Vermilyea v. *Vermilyea*, 61 Cal. App. 608, 215 P. 686 26
Wallace v. *United States*, 82-1 U.S. Tax Cas. (CCH) ¶ 13,442 37
Webster Investors, Inc. v. *Commissioner*, 19 T.C.M. (CCH) 396 38
Wisconsin Nipple & Fabricating Corp. v. *Commissioner*, 581 F.2d 1235 15
Zager v. *Commissioner*, 72 T.C. 1009, aff'd, 649 F.2d 1133 29

Statutes and regulations:

Act of Jan. 3, 1975, Pub. L. No. 93-625, Section 7(a)(1), 88 Stat. 2114 4
Economic Recovery Tax Act of 1981, Pub. L. No. 97-34, 95 Stat. 172 *et seq.*:
Section 401(b), 95 Stat. 299 35
Section 441(a), 95 Stat. 319 ..... 34, 36
Section 441(b), 95 Stat. 319 35
Section 442(a)(1), 95 Stat. 320 2
Section 442(e), 95 Stat. 323 2
Internal Revenue Code of 1939, ch. 2, 53 Stat. 1 *et seq.*:
Section 1003(b), 53 Stat. 146 36
Section 1004(a)(1), 53 Stat. 147 37
Internal Revenue Code of 1954, ch. 736, 68A Stat. 1 *et seq.*:
Section 2503(b), 68A Stat. 404 36
Section 2521, 68A Stat. 410 37
Section 6601(a), 68A Stat. 817 4
Internal Revenue Code of 1954 (26 U.S.C. (& Supp. V)):
Section 61 32
Section 102 ..... 30, 39
Section 163 ..... 31, 32
Section 166(d) (& Supp. V) 25
Section 170 42
Section 170(a)(1) 17
Section 170(f)(3) 42

Statutes and regulations—Continued: Page

Section 265(2) (Supp. V) 31
Section 482 33
Section 483 (& Supp. V) 33
Section 671 22
Section 673 22
Sections 674-677 22
Section 2501(a)(1) (Supp. V) 7, 8
Section 2501(a)(1) (1970 ed.) 2
Section 2503(b) (Supp. V) 34
Section 2503(e) (Supp. V) 35
Section 2505 (& Supp. V) 34, 35, 36, 37
Section 2511(a) 7
Section 2511(a) (1970 ed.) 2
Section 2512(a) 23
Section 2512(a) (1970 ed.) 2
Section 2512(b) (Supp. V) 2, 8, 22
Section 2512(b) (1970 ed.) 3
Section 2513(a) (Supp. V) 35
Section 2521 34
Section 2522(a) (& Supp. V) 42
Section 2522(c) (& Supp. V) 42
Section 6601 (& Supp. V) 4
Section 6621 (& Supp. V) 4
Revenue Act of 1924, ch. 234, Sections 319-324, 43 Stat. 313-316 8
Revenue Act of 1926, ch. 27, Section 1200, 44 Stat. 125 8
Revenue Act of 1932, ch. 209, 47 Stat. 169 *et seq.*:
Sections 501-507, 47 Stat. 245-249 8
Section 504(b), 47 Stat. 247 36
Section 505(a)(1), 47 Stat. 247 37
Section 517(a), 47 Stat. 254 36
Revenue Act of 1935, ch. 829, Section 301(b), 49 Stat. 1025 37
Revenue Act of 1938, ch. 289, Section 505, 52 Stat. 565 36
Revenue Act of 1942, ch. 619, 56 Stat. 798 *et seq.*:
Section 454, 56 Stat. 953 36
Section 455, 56 Stat. 953 37

Statutes and regulations—Continued: Page

Tax Equity and Fiscal Responsibility Act of 1982, Pub. L. No. 97-248, Section 345(a), 96 Stat. 636 4
Tax Reform Act of 1976, Pub. L. No. 94-455, Section 1902(a)(10), 90 Stat. 1805 2
Fla. Stat. Ann. (West):
§ 95.11(k) (1982) 26
§ 95.281 (1982) (formerly § 95.031(1)) 26
§ 673.3-122(2) (1966 & Cum. Supp. 1983) 26
U.C.C. § 3-122(1)(a) 26
26 C.F.R.:
Section 1.170A-1(c)(1) 17
Section 1.170A-7(d) 42
Section 25.2511-1(c) 12
Section 25.2511-1(g)(1) 30
Section 25.2511-1(h)(1) 3, 30
Section 25.2511-2(c) 12
Section 25.2511-2(f) 13, 23
Section 25.2512-1 28
Section 25.2512-5(c) 16
Section 25.2512-8 ..... 12, 30
Section 25.2512-9(f) 28, 29
Treas. Reg. 67, Art. I (1924) 12
Treas. Reg. 79, Art. 2 (1933) 12
Treas. Reg. 79 (1936):
Art. 2 12
Art. 3 12
Treas. Reg. 108, § 86.2(a) (1943) 12

Miscellaneous:

Aslanides & McGowan, *Interest-Free Loans Get Green Light as Compensation and Estate Planning Devices*, 21 Tax Acct. 260 (1978) 20
Benefied, *Gross Income—Interest-Free Loans*, 13 Mercer L. Rev. 421 (1962) 13
Bettner, *Interest-Free Loan to Poorer Relations Can Cut Income Taxes if He Invests Money in His Name*, Wall St. J., Dec. 20, 1982 20

Miscellaneous—Continued: Page

Burke, *Interest-Free Loans—A Valuable Family Tax Planning Tool?*, 48 Taxes 137 (1970) 20
Carey, *Interest-Free Loans and the Gift Tax: Crown v. Commissioner*, 38 Ohio St. L.J. 903 (1977) 24
65 Cong. Rec. (1924):
pp. 3119-3120 21
pp. 8095-8096 19
Cooper, *A Voluntary Tax? New Prespectives on Sophisticated Estate Tax Avoidance*, 77 Colum. L. Rev. 161 (1977) 20
H. Dubroff & D. Kahn, *Federal Taxation of Estates, Gift and Trusts* (3d ed. 1980) 24
Economic Report of the President, H.R. Doc. No. 97-123, 97th Cong., 2d Sess. (1982) 4, 14, 28
Edwards, *What Planning Opportunities Does CA-7's No-Gift—Tax Holding in Crown Open Up?*, 50 J. Tax'n 168 (1979) 20
Griswold, *A Summary of the Regulations Problem*, 54 Harv. L. Rev. 398 (1941) 15
Griswold, *Charitable Gifts of Income and the Internal Revenue Code*, 65 Harv. L. Rev. 84 (1951) 10
Harriss, *Legislative History of Federal Gift Taxation*, 19 Taxes 531 (1940) 8
H.R. Rep. No. 708, 72d Cong., 1st Sess. (1932) 9, 19, 21, 23
H.R. Rep. No. 2333, 77th Cong., 2d Sess. (1942) .. 25
H.R. Rep. No. 91-413 (Pt. 1), 91st Cong., 1st Sess. (1969) 42
Joyce & Del Cotto, *Interest-Free Loans: The Odyssey of a Misnomer*, 35 Tax L. Rev. 459 (1980) .. 24
C. Lowndes, R. Kramer & J. McCord, *Federal Estate and Gift Taxes* (3d ed. 1974) 8
Note, *Interest-Free Loans: Opportunities for Tax Planning*, 65 A.B.A. J. 634 (1979) 20
Note, *The Value of the Use of Money Loaned by Taxpayers to Their Children Without Interest Does Not Constitute a Gift*, 5 Hous. L. Rev. 138 (1967) 14, 24

Miscellaneous—Continued: Page

O'Hare, *The Taxation of Interest-Free Loans*, 27 Vand. L. Rev. 1085 (1974) 24, 40
2 R. Paul, *Federal Estate and Gift Taxation* (1942 ed.) 10
2 R. Powell, *The Law of Real Property* (1977) 17
Pulliam, *Income and Gift Tax Implications of Non-business Interest-Free Loans: Looking a Gift Horse in the Mouth*, 58 Taxes 675 (1980) 24
Recent Development—Gift Taxes—Interest-Free Demand Notes Are Not Taxable Gifts—Johnson v. United States, 65 Mich. L. Rev. 1014 (1967) .. 24
Restatement of the Law of Property (1936) 17
Restatement (Second) of Property of Landlord & Tenant (1977) 9
Rev. Rul. 64-225, 1964-2 Cum. Bull 15 11
Rev. Rul. 66-167, 1966-1 Cum. Bull. 20 11
Rev. Rul. 73-61, 1973-1 Cum. Bull. 408 ..... 17, 27
Rev. Rul. 81-286, 1981-2 Cum. Bull. 177 21
Rev. Rul. 81-264, 1981-2 Cum. Bull. 186 26
Seidman & Stuetzer, *Tax Clinic*, 120 J. Acct. 75 (1965) 20
S. Rep. No. 665, 72d Cong., 1st Sess. (1932) .. 9, 19, 21, 23
S. Rep. No. 91-552, 91st Cong., 1st Sess. (1969) 42
S. Rep. No. 94-938, 94th Cong., 2d Sess. (1976) 2
R. Stephens, G. Maxfield, S. Lind & D. Calfee, *Federal Estate and Gift Taxation* (5th ed. 1983) 24, 35
S. Surry, W. Warren, P. McDaniel & H. Ault, *Federal Income Taxation: Cases and Material* (1972) 17
S. Surry, W. Warren, P. McDaniel & H. Gutman, *Federal Wealth Transfer Taxation: Cases and Material* (2d ed. 1982) 24
Taicher, *How to Use Interest-Free Loans in Family Tax Planning*, 11 Prac. Acct. 24 (Sept. 1978) 20
Thater & Richey, *An Overview of Cases Dealing with Interest-Free Loans*, 121 Tr. & Est. 35 (Dec. 1982) 20

Miscellaneous—Continued: Page

Tidwell, *Lester Crown Points the Way to Estate Tax Reduction Under the 1976 Tax Reform Act*, 55 Taxes 651 (1977) 20

1 H. Tiffany, *The Law of Real Property* (3d ed. 1939) 17

Westover, *Gift Taxation of Interest-Free Loans*, 19 Stan L. Rev. 870 (1967) 14, 24

Wilkes, *Tax Court Holds Interest-Free Loans to Shareholders Creates No Taxable Income*, 14 J. Tax'n 351 (1961) 13

In the Supreme Court of the United States

OCTOBER TERM, 1983

No. 82-1041

ESTHER C. DICKMAN, ET AL., PETITIONERS

v.

COMMISSIONER OF INTERNAL REVENUE

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE ELEVENTH CIRCUIT

BRIEF FOR THE RESPONDENT

OPINIONS BELOW

The opinion of the court of appeals (Pet. App. 1a-14a) is reported at 690 F.2d 812. The opinion of the Tax Court (Pet. App. 15a-24a) is unofficially reported at 41 T.C.M. (CCH) 620.

JURISDICTION

The judgment of the court of appeals was entered on November 1, 1982. The petition was filed on December 17, 1982, and was granted on February 22, 1983. The jurisdiction of this Court rests on 28 U.S.C. 1254(1).

STATUTORY PROVISIONS INVOLVED

26 U.S.C. (1970 ed.) 2501(a)(1), as in effect during the periods here in issue,[1] provides:

> For the first calendar quarter of calendar year 1971 and each calendar quarter thereafter a tax, computed as provided in section 2502, is hereby imposed on the transfer of property by gift during such calendar quarter by any individual, resident or nonresident.

26 U.S.C. (1970 ed.) 2511(a) provides in pertinent part:

> Subject to the limitations contained in this chapter, the tax imposed by section 2501 shall apply whether the transfer is in trust or otherwise, whether the gift is direct or indirect, and whether the property is real or personal, tangible or intangible * * *.

26 U.S.C. (1970 ed.) 2512(a) and (b), as in effect during the periods here in issue,[2] provided:

> (a) If the gift is made in property, the value thereof at the date of the gift shall be considered the amount of the gift.
>
> (b) Where property is transferred for less than an adequate and full consideration in

---

[1] In 1976, a non-substantive amendment was made to Section 2501(a)(1). See Tax Reform Act of 1976, Pub. L. No. 94-455, Section 1902(a)(10), 90 Stat. 1805; S. Rep. No. 94-938, 94th Cong., 2d Sess. 521 (1976). Effective for gifts made after December 31, 1981, the gift tax was made payable on a yearly basis. See Economic Recovery Tax Act of 1981, Pub. L. No. 97-34, Section 442(a)(1) and (e), 95 Stat. 320 and 323.

[2] The current version does not refer to "the calendar quarter." 26 U.S.C. (Supp. V) 2512(b); see note 1, *supra*.

money or money's worth, then the amount by which the value of the property exceeded the value of the consideration shall be deemed a gift, and shall be included in computing the amount of gifts made during the calendar quarter.

STATEMENT

Paul and Esther C. Dickman were husband and wife until Paul's death in December, 1976 (Pet. App. 2a, 17a). For many years, beginning as early as 1963 (see JX 49-AW[3]), they made interest-free loans totalling hundreds of thousands of dollars to their child, Lyle C. Dickman (who died in May, 1976), and to a family-owned corporation, Artesian Farms, Inc. (Artesian) (Pet. App. 2a, 18a-19a).[4] The loans at issue here are those that were outstanding in the calendar years 1971 through 1976, ranging from totals of $370,846 to $569,046 for Lyle and from $276,526 to $738,384 for Artesian (Pet. App. 2a n.2). Substantially all the loans were evidenced by noninterest bearing demand notes.[5]

---

[3] "JX" refers to the joint exhibits in the United States Tax Court. "Exh." refers to the exhibits attached to the petitions in the United States Tax Court.

[4] Artesian's stock was owned by Paul, Esther and Lyle Dickman, and by Lyle's wife and three children. Their proportionate shares are identified in the court of appeals' opinion (Pet. App. 2a n.1). The Commissioner treated gifts to Artesian as gifts to its shareholders in proportion to their stock interests, pursuant to Treasury Regulations on Gift Tax (1954 Code), 26 C.F.R. 25.2511-1(h)(1). See Exh. A.

[5] One $65,000 loan was made to Lyle on "open account" (without a written note); it was payable on demand. Another loan in the amount of $456,805.90, made to Artesian in March 1972, was evidenced by a ten-year note (Pet. App. 2a-3a, 19a-20a).

On audit, the Commissioner of Internal Revenue concluded that the loans were payable on demand and resulted in continuing gifts for the period during which the loans were outstanding in an amount equal to the value of the loans. The Commissioner determined that value by multiplying the loan balance outstanding at the end of each taxable quarter by the interest rates applicable under 26 U.S.C. (& Supp. V) 6601 and 6621 to tax underpayments for that quarter (Pet. App. 3a n.4, 21a).[6] On that basis, the Commissioner determined deficiencies in gift tax for all calendar quarters in the years 1971 through 1976. The deficiencies totalled $83,332.69 (Pet. App. 3a-4a, 21a).

Petitioners sought redetermination in the Tax Court of the gift tax deficiencies determined by the

---

[6] These rates were as follows:

Periods	Interest Rate
Jan. 1, 1971-June 30, 1975	6%
July 1, 1975-Jan. 31, 1976	9%
Feb. 1, 1976-Dec. 31, 1976	7%

During these same periods, the prime rate ranged between 5.25% and 10.81%. See *Economic Report of the President*, H.R. Doc. No. 97-123, 97th Cong., 2d Sess., Table B-67 at 310 (1982) (hereinafter cited as H.R. Doc. No. 97-123).

Section 6601(a), as originally enacted, simply provided a straight 6% interest rate for underpayments. See Internal Revenue Code of 1954, ch. 736, Section 6601(a), 68A Stat. 817. In 1975, the 1954 Code was amended to provide a 9% rate, but subject to biennial adjustment to reflect changes in the "adjusted prime rate charged by banks." See Section 6621, as added by Section 7(a)(1), Act of Jan. 3, 1975, Pub. L. No. 93-625, 88 Stat. 2114. (Section 6621 now provides for semi-annual adjustment of the interest rate. See Tax Equity and Fiscal Responsibility Act of 1982, Pub. L. No. 97-248, Section 345(a), 96 Stat. 636.)

Commissioner.[7] The Tax Court held that none of the instant loans resulted in taxable gifts (Pet. App. 15a-24a), following its earlier holding in *Crown* v. *Commissioner*, 67 T.C. 1060 (1977) (reviewed by the court), nonacq., 1978-2 Cum. Bull. 3, aff'd, 585 F.2d 234 (7th Cir. 1978).

The court of appeals reversed (Pet. App. 1a-14a). Disagreeing with the Seventh Circuit's *Crown* decision, the court held that "interest-free loans are subject to the gift tax whether the loans are made for a fixed term or are on a demand basis" (Pet. App. 1a). The court found this conclusion "compelled by the gift tax statute as it is illuminated by its legislative history, established treasury regulations, judicial interpretation, and the policy considerations underlying it" (*id.* at 13a). The court of appeals accordingly remanded the case to the Tax Court to determine the amount of the taxable gifts (*id.* at 1a).[8]

SUMMARY OF ARGUMENT

Paul and Esther C. Dickman gave their son, Lyle, and his family (through their corporation, Artesian),

---

[7] By amended answer, the Commissioner contended that the $456,805.90 loan (see note 5, *supra*) was a 10-year term loan, which resulted in a gift in the calendar quarter in which it was made equal to the difference between the amount lent and the fair market value of the term note given by Artesian (Pet. App. 20a, 21a). The Tax Court, however, found that the loan in question was in fact a demand loan (*id.* at 23a-24a).

[8] The court declined to decide whether the Tax Court had correctly found that the $456,805.90 loan was a demand loan, stating that the characterization of that loan related to the valuation issue, and "it is not absolutely clear at this point what difference the characterization will make since we hold that both term and demand loans produce taxable consequences" (Pet. App. 3a n.3).

the right to use, interest-free, hundreds of thousands of dollars for extended periods of time. The transfers of that right were transfers of "property," whether the rights conferred were to last for a predetermined time or were terminable at any time by the lenders. It is conceded that those transfers were made without consideration. Accordingly, although the loans themselves were not gifts, they were transactions whereby property was gratuitously transferred.

The federal gift tax covers any gratuitous transfer of any interest in property. This Court and the Commissioner's regulations have long recognized that the gift tax was designed to be all-inclusive. There is no reason to exclude from its reach the gratuitous donation of the valuable right to use money or any other property for substantial periods of time, whether that right is granted originally for a specific term or, as in a demand loan, is granted throughout the time it remains outstanding. Instead, including such gratuitous transfers effectuates the basic purpose of the gift tax, because it prevents taxpayers from avoiding income and estate taxes by the simple expedient of making large tax-free demand loans to their intended beneficiaries.

There is no significant distinction, for gift tax purposes, between low interest term loans, which have been recognized as giving rise to taxable gifts, and interest-free or low interest demand loans. Indeed, in the family context, such demand loans are properly viewed as indefinite term loans. While the valuation of such loans may be made only at the close of the period for which they have remained outstanding, this does not justify treating them differently than traditional term loans for gift tax purposes. The valuation of such loans involves simply the calculation

of the value of the right to use the money involved (as reflected in the appropriate interest rate) for the period the loan remains outstanding.

Whether interest-free loans result in taxable income to the recipient is an entirely separate question. While we disagree with cases refusing to recognize such income on the ground that if the borrower were required to pay interest that interest would be a deductible expense, that rationale is inapplicable in the gift tax context. Finally, treating the gratuitous donation of the right to use money or other property for extended periods of time as within the purview of the gift tax will cause neither administrative problems nor anomalies in the application of the tax laws. Because of the substantial exemptions and exclusions from the gift tax, ordinary loans between family members, like the usual intra-family gifts, simply do not create gift tax liability.

ARGUMENT

I. THE GIFT TAX REACHES ANY GRATUITOUS TRANSFER OF ANY INTEREST IN PROPERTY

A. The Statute And The Regulations

The statutory language of the federal gift tax establishes that it reaches any gratuitous transfer of any interest in property. Section 2501(a)(1) of the Internal Revenue Code of 1954 (26 U.S.C. (Supp. V)) imposes a gift tax on any "transfer of property by gift" made by an individual during the taxable quarter. Section 2511(a) (26 U.S.C.) provides that "the tax imposed by section 2501 shall apply whether the transfer is in trust or otherwise, whether the gift

is direct or indirect, and whether the property is real or personal, tangible or intangible." [9]

The Committee reports accompanying the Revenue Act of 1932, ch. 209, Sections 501-507, 47 Stat. 245-249, in which the present federal gift tax was enacted,[10] emphasize Congress's specific intent to reach all gratuitous transfers of any type of interest in property:

> The terms "property," "transfer," "gift," and "indirectly" are used in the broadest and most comprehensive sense; the term "property" reaching every species of right or interest protected by law and having an exchangeable value.
>
> The words "transfer * * * by gift" and "whether * * * direct or indirect" are designed to cover and comprehend all transactions (subject to certain express conditions and limitations) whereby and to the extent * * * that property or a property right is donatively passed to or conferred upon another, regardless of the means or the device employed in its accomplishment.

---

[9] Section 2512(b) (26 U.S.C. (Supp. V)) makes clear that the taxable "transfer of property by gift" (26 U.S.C. (Supp. V) 2501(a)(1)) includes situations in which the fair market value of property transferred exceeds the consideration received in a bargain sale or other unequal exchange.

[10] In 1924, Congress had enacted an earlier gift tax, Revenue Act of 1924, ch. 234, Sections 319-324, 43 Stat. 313-316, which was repealed two years later by Section 1200 of the Revenue Act of 1926, ch. 27, 44 Stat. 125. The 1924 gift tax was computed annually without taking into account the donor's previous gifts; there was an exemption for $50,000 in gifts each year. C. Lowndes, R. Kramer & J. McCord, *Federal Estate and Gift Taxes* § 22.1, at 639-640 (3d ed. 1974); Harriss, *Legislative History of Federal Gift Taxation*, 19 Taxes 531 (1940).

H.R. Rep. No. 708, 72d Cong., 1st Sess. 27-28 (1932); S. Rep. No. 665, 72d Cong., 1st Sess. 39 (1932).[11]

In light of these clear indications of Congress's intent that the gift tax was to be comprehensive, "there is little need to specifically enumerate interest-free loans as a taxable gift or as included in the term 'all transactions.'" *Crown* v. *Commissioner*, *supra*, 585

---

[11] The *Crown* court concluded (585 F.2d at 239) that the borrower who received an interest-free demand loan had neither an interest "protected by law" nor one with "an exchangeable value." But the fact that the borrower must repay the loan when the lender demands it surely does not mean he has no legally protectable interest at all. "At will" interests are property, legally enforceable against third parties (pages 17-19, *infra*); and, of course, the borrower's rights to the earnings on the funds lent that accrue while he holds them are legally enforceable against all persons, including the lender. Moreover, the property interests here—the right to use money—clearly have an exchangeable value. Unlike an "at will" interest in real property, where the tenant's attempted transfer could terminate his estate (*Restatement (Second) of Property of Landlord & Tenant* § 1.6 comment d (1977)), it is evident that recipients of cash loans have the right to use the money in the only way it has utility—by transferring it for value received. Even if the lender restricts the uses for which the loans may be spent (and there is no evidence that any such restrictions were imposed here) that does not deprive the property interest the borrower received of all "exchangeable value." For example, if a taxpayer lends his son $100,000 for the son to use to purchase stock, the son has received property having exchangeable value, even if the terms of the loan provide that the son must use the loan only to purchase a particular stock. Indeed, any other rule would provide a simple mechanism for avoiding the gift tax on interest-free loans. Many loans of personal property contemplate consumption or transfer of the property lent, ranging from the neighbor's loan of a cup of sugar to the broker's loan of securities to effectuate a short sale. Cf. *Deputy* v. *Du Pont*, 308 U.S. 488 (1940).

F.2d at 242 (Van Pelt, J., dissenting). Indeed, as observed by Randolph Paul:

> The very breadth of the gift concept renders it impossible to make a complete enumeration of the types of transfers subject to tax. Moreover, any specific enumeration would be unwise from the revenue standpoint. To define is to limit, and the purpose of Congress was undoubtedly to exert its taxing power to a sweeping extent.

2 R. Paul, *Federal Estate and Gift Taxation* § 16.03, at 1069 (1942) (footnotes omitted).[12]

This Court on several occasions has recognized that the gift tax was intended to be all-inclusive.[13] Thus, in *Commissioner* v. *Wemyss*, 324 U.S. 303, 306 (1945), the Court explained that "Congress intended

---

[12] Amicus Jones, Day is thus wrong in asserting (Br. 4, 10-12) that the gift tax statute is ambiguous and should not be applied to the instant transfers absent "specific congressional authority." But even if the statute were ambiguous, it would be appropriate for the Commissioner and the courts to resolve that ambiguity. Griswold, *Charitable Gifts of Income and the Internal Revenue Code*, 65 Harv. L. Rev. 84, 90 (1951) ("We have had enough experience with the tax laws to know that Congress cannot do everything, and that it is ordinarily a mistake to expect that Congress will formulate precise rules to cover every refinement and detail of human experience so far as its tax results are concerned. Many of the interstices must, of necessity, be filled in by the courts and by administrative action.").

[13] *Smith* v. *Shaughnessy*, 318 U.S. 176, 180 (1943) ("[t]he language of the gift tax statute, 'property * * * real or personal, tangible or intangible,' is broad enough to include property, however conceptual or contingent"); *Robinette* v. *Helvering*, 318 U.S. 184, 187 (1943) (purpose of the gift tax is to "reach every kind and type of transfer by gift"); *Jewett* v. *Commissioner*, 455 U.S. 305, 310 (1982) (gift tax is to be given "expansive reading").

to use the term 'gifts' in its broadest and most comprehensive sense," and noted "the evident desire of Congress to hit all the protean arrangements which the wit of man can devise that are not business transactions within the meaning of ordinary speech." The Court concluded that Congress had adopted a "workable external test" under which there is a gift whenever there is a transfer of property by an individual, not in the regular course of business, for less than adequate and full consideration. *Id.* at 306-307.[14] In its sweep the gift tax is thus comparable to the income tax, where Congress exerted " 'the full measure of its taxing power.' " *Commissioner* v. *Glenshaw Glass Co.*, 348 U.S. 426, 429 (1955), quoting *Helvering* v. *Clifford*, 309 U.S. 331, 334 (1940).

The Treasury regulations have always reflected the broad sweep of the statutory language. Thus, the

---

[14] This interpretation refutes petitioners' claim (Br. 19) that the words "transfer of property by gift" must be read "literally and in accordance with their ordinary, everyday meaning" and that "whatever the borrower may have in a demand loan situation, it is not 'property' as that term is ordinarily used" (*id.* at 22-23). That claim is also inconsistent with *Boston & Lowell R.R.* v. *Salem & Lowell R.R.*, 68 Mass. (2 Gray) 1, 35 (1855) ("property is *nomen generalissimum*, and extends to every species of valuable right and interest"). Petitioners seek support in cases interpreting the common-law definition of the term "gift" (Br. 10 n.6). Those cases, however, have no relevance here since "common law considerations were not embodied in the gift tax." *Wemyss*, *supra*, 324 U.S. at 306 (footnote omitted). Nor is it relevant that gifts of services may not give rise to taxable gifts (Pet. Br. 25). See, *e.g.*, Rev. Rul. 66-167, 1966-1 Cum. Bull. 20. A gift of services simply does not involve a transfer of "property." But cf. Rev. Rul. 64-225, 1964-2 Cum. Bull. 15 (waiver of vested right to receive payment for services effects taxable gift).

original regulations issued under the Revenue Act of 1932 provided:

> [A]ll transactions whereby property or property rights or interests are donatively passed or conferred upon another, regardless of the means or device employed, constitute gifts subject to tax.

Treas. Reg. 79, Art. 2 (1933); Treas. Reg. 79, Art. 2 (1936).[15] This language has appeared (with the single substitution of the word "gratuitously" for "donatively") in all subsequent gift tax regulations, including the current ones. See Treas. Reg. 108, § 86.2(a) (1943); Treasury Regulations on Gift Tax (1954 Code), 26 C.F.R. 25.2511-1(c).[16]

The regulations also have long recognized that taxable gifts may result where the donor retains an interest in the property transferred, as when he makes a term or demand loan. Section 25.2511-2(c) (26 C.F.R.) provides that a transfer of a term estate results in a taxable gift equal to the value of that estate. A term loan is not different in any relevant respect from a term estate in property. And, significantly, the regulations have since 1936[17] stated

---

[15] Treasury regulations promulgated under the prior gift tax similarly provided that "[t]he subject of the gift may consist of any species of property or interest therein, whether legal or equitable." See Treas. Reg. 67, Art. 1 (1924).

[16] See also 26 C.F.R. 25.2512-8, providing that:

> Transfers reached by the gift tax are not confined to those only which, being without a valuable consideration, accord with the common law concept of gifts, but embrace as well sales, exchanges, and other dispositions of property for a consideration to the extent that the value of the property transferred by the donor exceeds the value in money or money's worth of the consideration given therefor.

[17] See Treas. Reg. 79, Art. 3 (1936).

that in the case of a transfer of property which is not a taxable gift of that property because the transferor retains power over the disposition of the property, any "receipt of income or of other enjoyment of the transferred property by the transferee" during the period before the gift is complete "constitutes a gift of such income or of such other enjoyment taxable as of the calendar quarter * * * of its receipt." 26 C.F.R. 25.2511-2(f). The loans to Lyle and Artesian were not gifts of the sums transferred because they agreed to repay those amounts upon demand. However, since they received the right to use that money (and thus the right to retain all earnings attributable to that money) in the taxable periods involved, they received the beneficial enjoyment of that transferred property, which under 26 C.F.R. 25.2511-2(f) constitutes a taxable gift to the extent of the value of that right.

Petitioners (Br. 12) and the Seventh Circuit in *Crown*, *supra*, 585 F.2d at 241, are accordingly incorrect in asserting that the Commissioner's view that interest-free demand loans result in taxable gifts is a recent departure from established administrative interpretations. See also pages 22-33, *infra*.[18] Despite

[18] Similarly, Amicus Jones, Day's assertion (Br. 6-10) that the courts' rejection of the government's views in *Johnson* v. *United States*, 245 F. Supp. 73 (N.D. Tex. 1966), and *Dean* v. *Commissioner*, 35 T.C. 1083 (1961), non acq., 1973-1 Cum. Bull. 4, reflected a judicial unwillingness to adopt a novel administrative interpretation is hardly in accord with contemporary statements by legal commentators. See, *e.g.*, Wilkes, *Tax Court Holds Interest-Free Loans to Shareholder Creates No Taxable Income*, 14 J. Tax'n 351, 351 (1961) (*Dean* decision represents "a bold step into a new and interesting area"); Benefied, *Gross Income—Interest-Free Loans*, 13 Mercer L. Rev. 421, 424 (1962) ("Is this [*Dean*] the beginning of a new

the fact that the first case to be litigated involving the gift taxation of interest-free demand loans (*Johnson* v. *United States*, 254 F. Supp. 73 (N.D. Tex. 1966)) was decided less than 20 years ago,[19] and the Commissioner did not issue a ruling on the subject until 1973,[20] it was nevertheless reasonably clear from

---

trend in taxing policy or is the exclusion of this benefit from gross income just a mistake?"); Westover, *Gift Taxation of Interest-Free Loans*, 19 Stan. L. Rev. 870 (1967); Note, *The Value of the Use of Money Loaned by Taxpayers to Their Children Without Interest Does Not Constitute a Gift*, 5 Hous. L. Rev. 138, 141-142 (1967) ("an examination of the law and the facts clearly shows the lack of justification for this decision [*Johnson*, *supra*]"). See also pages 29-33, *infra*, (distinguishing *Dean*).

[19] The lack of earlier cases may well be due to the fact that interest rates, until fairly recently, have been relatively low. H.R. Doc. No. 97-123, *supra*, Table B-67, at 310 (from 1933 to 1960, the prime interest rate ranged between 1.5% and 4.82%). At such low interest rates, taxpayers could lend large sums without exceeding the per donee exclusion and lifetime exemption. See pages 34-36, *infra*. In addition, although as petitioners assert (Br. 9), "[i]n 1932, as today, interest-free demand loans within families were common features of American life," it appears that the use of interest-free loans by wealthy taxpayers of sufficient amount to generate gift tax liability has increased greatly in frequency in recent years. See, *e.g.*, Am. Br. D'Ancona & Pflaum 5. See also the articles advocating the use of interest-free loans, page 20 note 26, *infra*.

[20] There are myriad transactions that may have tax consequences. It is obviously impossible to publish a ruling as to each such transaction or type of transaction and the failure to do so is not an announcement that such transactions are outside the tax law. See *Helvering* v. *Hallock*, 309 U.S. 106, 120-121 (1940) ("inaction by the Treasury can hardly operate as a controlling administrative practice, through acquiesence, tantamount to an estoppel").

earlier regulations that the gift tax does reach the value conferred by interest-free demand loans.[21]

B. Application To Interest-Free Loans

Paul and Esther C. Dickman gave their son, Lyle, and his family the right to use, interest-free, hundreds of thousands of dollars for many years. Under the broad statutory language as interpreted by this Court and longstanding treasury regulations, these loans clearly resulted in taxable gratuitous transfers of property. This result follows, as the Court below recognized, for all the loans, whether they were payable after a predetermined set period (see notes 5, 7, 8, *supra*), or were payable on demand.

The right to use property for a predetermined definite period of time is itself "property," whether the underlying property is real estate, money or other

---

[21] Even if the Commissioner had made an administrative interpretation that interest-free loans do not result in taxable gifts, it is well settled that the Commissioner may change that interpretation, if incorrect, and may even do so retroactively. See *Dixon* v. *United States*, 381 U.S. 68, 72-73 (1965); *Automobile Club* v. *Commissioner*, 353 U.S. 180, 183-184 (1957); *Helvering* v. *Wilshire Oil Co.*, 308 U.S. 90, 101 (1939); *Wisconsin Nipple and Fabricating Corp.* v. *Commissioner*, 581 F.2d 1235 (7th Cir. 1978). Several of the loans here were, in any event, made after the issuance of the 1973 Revenue Ruling (Pet. App. 2a-3a n.2, 19a).

There is no merit to the argument of amicus Jones, Day (Br. 13 n.18) that the mere reenactment or amendment of a tax statute freezes the scope of the statute in the contours of administrative interpretations previously made. See Griswold, *A Summary of the Regulations Problem*, 54 Harv. L. Rev. 398, 399 n.7, 400 (1941) (*"the mere reenactment of a statute following administrative construction should be given no weight whatever in determining the proper construction of the statute"*); cf. *Helvering* v. *Hallock*, *supra*, 309 U.S. at 119-120.

property. *Threlfall* v. *United States*, 302 F. Supp. 1114, 1117-1118 (W.D. Wis. 1969) (term leasehold is property); *Allen* v. *Commissioner*, 57 T.C. 12 (1971) (same).[22] The same result follows where the right to use property is not for a definite predetermined period, but is to last for some indefinite period. See Treasury Regulations on Gift Tax (1954 Code), 26 C.F.R. 25.2512-5(c) (right to use property for the life of another person is property); *Abbott* v. *United States*, 74-2 U.S. Tax Cas. (CCH) ¶ 13,040 (S.D. Miss. 1974) (same); *Sullivan* v. *Commissioner*, 16 T.C. 228, 231 (1951), acq., 1951-1 Cum. Bull. 3 (right to use property for duration of war is property); *Thriftimart, Inc.* v. *Commissioner*, 59 T.C. 598, 615-616 (1973), acq., 1973-2 Cum. Bull. 4, remanded on other issues, No. 73-3108 (9th Cir. Dec. 10, 1975) (lease terminable by owner on sale of building is property). Indeed, petitioners (Br. 20-23, 29 n.23) apparently do not contest these evident principles (see also Am. Br. Jones, Day 17 n.23).[23]

---

[22] As the court explained in *Passailaigue* v. *United States*, 224 F. Supp. 682, 686 (M.D. Ga. 1963):

> "Property" is more than just the physical thing—the land, the bricks, the mortar—it is also the sum of all the rights and powers incident to ownership of the physical thing. It is the tangible and intangible. Property is composed of constituent elements and of these elements the right to *use* the physical thing to the exclusion of others is the most essential and beneficial. Without this right all other elements would be of little value, for if the owner is deprived of the use of the tangible thing, little more than a barren title is left in his hand.

[23] Amicus Jones, Day does attempt to distinguish the cited cases on the ground that they "involved charitable deductions, and the operative statute in each required only a 'contribution,' not a 'transfer of property by gift' " (Br. 17 n.23). However,

It is equally clear that the right to use property for an indefinite period, terminable at any time by the property's owner, also is "property." Rev. Rul. 73-61, 1973-1 Cum. Bull. 408; *Passailaigue* v. *United States*, 224 F. Supp. 682, 686 (M.D. Ga. 1983). Indeed, it is, for example, blackletter law that a tenancy at will in real property is an "estate," *i.e.*, a property interest. See *Restatement of the Law of Property* §§ 9, 21 (1936); *Covina Manor, Inc.* v. *Hatch*, 133 Cal. App. 2d Supp. 790, 792-793, 284 P.2d 580, 582 (App. Dep't Super. Ct. 1955); *Public Service Co.* v. *Voudomas*, 84 N.H. 387, 388-390, 151 A. 81, 83-84 (1930); 2 R. Powell, *The Law of Real Property* ¶ 256 (1977); 1 H. Tiffany, *The Law of Real Property* ¶ 155 (3d ed. 1939). As the Fourth Circuit observed in *United States* v. *Smoot Sand & Gravel Corp.*, 248 F.2d 822, 827 (1957) (footnote omitted):

> It cannot be disputed that when one is assigned the right, pending its revocation, to use or consume something to the exclusion of all others, and to receive compensation from anyone who ven-

---

although Section 170(a)(1) of the 1954 Code relating to charitable deductions does not specifically use the word, it is understood that it requires a transfer of "property". See, *e.g.*, *Orr* v. *United States*, 343 F.2d 553, 555 (5th Cir. 1965) (" 'The Code contemplates a contribution of money or property'[.] * * * [citing] 5 J. Mertens, The Law of Federal Income Taxation § 31.05, 35." See also 26 C.F.R. 1.170A-1(c)(1). Indeed, a well-recognized line is drawn between the nondeductible rendering to charity of a personal service and the deductible contribution of "property." See 1 S. Surrey, W. Warren, P. McDaniel & H. Ault, *Federal Income Taxation: Cases and Materials* 580 (1972). Moreover, regardless of whether Section 170 requires a transfer of "property" in all instances, amicus ignores the fact that several of the cases in question specifically decided that the interests transferred constituted "property." See, *e.g.*, *Thriftimart, Inc.*, *supra*, 59 T.C. at 615

> tures to exercise the privilege without his authority, he has a species of property, regardless of what theory of property we may adopt.

The economic realities of the instant transactions lead to the same conclusion that a gratuitous transfer of property has occurred. By making interest-free loans to Lyle and Artesian, the Dickmans effectively transferred to them the valuable economic control over hundreds of thousands of dollars.[24] As this Court has recognized, albeit in a different context, the making of an interest-free loan results in the transfer of a valuable economic right:

> It is virtually self-evident that extending interest-free credit for a period of time is equivalent to giving a discount equal to the value of the use of the purchase price for that period of time.

Catalano, Inc. v. *Target Sales, Inc.*, 446 U.S. 643, 648 (1980). See also *Martin* v. *Commissioner*, 649 F.2d 1133, 1136 (5th Cir. 1981) (Goldberg, J., dissenting):

---

[24] Moreover, as observed by Tax Court Judge Simpson in his dissent in *Crown, supra*, had the taxpayers there "arranged for the borrowers to obtain the money from financial institutions and agreed to pay the interest thereon, clearly, the payment of such interest would constitute a taxable gift" (67 T.C. at 1066). Where taxpayers achieve precisely the same economic result by lending the money directly, we submit that there is no justification for a different tax treatment. Indeed, the instant transaction is also similar in economic substance to the situation where the donor retains funds in an interest-bearing account but transfers to the donee the right to receive the interest payments for an indefinite period—obviously a taxable gift. Surely the transfers here are no less taxable gifts merely because the donees had additional options in the use of the money besides depositing it in an interest-bearing account and keeping the proceeds.

The use of money—the opportunity to make additional income or to spend today and pay tomorrow—is a valuable right, which individuals must usually pay for by securing interest-bearing loans. Interest is a form of "rent" for the use of money.

II. THE HOLDING BELOW EFFECTUATES THE CONGRESSIONAL POLICY UNDERLYING THE GIFT TAX STATUTE

The gift tax was specifically designed to supplement both the income tax and the estate tax, by taxing inter-vivos gifts and thereby preventing taxpayers from reducing their yearly incomes as well as their gross estates through tax-free gifts to close family members and others. H.R. Rep. No. 708, 72d Cong., 1st Sess. 28 (1932); S. Rep. No. 665, 72d Cong., 1st Sess. 40 (1932). See also 65 Cong. Rec. 8095-8096 (1924); *Harris* v. *Commissioner*, 340 U.S. 106, 107 (1950); *Smith* v. *Shaughnessy*, 318 U.S. 176, 179 & n.1 (1943); *Estate of Sanford* v. *Commissioner*, 308 U.S. 39, 44 (1939).[25] Here, Paul and Esther C. Dickman shifted to Lyle and Artesian the income that would be generated by the money lent them, thereby reducing their own income taxes and ultimately the amounts of their taxable estates.

If interest-free demand loans are not subject to gift taxes, the potential loss of tax revenues may be

---

[25] As the Seventh Circuit in *Crown* acknowledged (585 F.2d at 236; footnote omitted):

> The concern here is that people will use gifts of income producing property to split up an income taxable in a high tax bracket into smaller incomes taxable in lower brackets. No-interest loans do just that. Moreover, where the loans are payable on demand, the maker of the loans is able to achieve this result without the inconvenience of losing access to the principal should the need arise.

quite substantial in light of the fact that tax practitioners and financial advisers have recognized and widely advocated the use of such loans as a device to split incomes and reduce estate taxes. Am. Br. D'Ancona & Pflaum 5; Cooper, *A Voluntary Tax? New Perspectives on Sophisticated Estate Tax Avoidance*, 77 Colum. L. Rev. 161, 186 (1977).[26] In the *Crown* case alone, the taxpayers successfully transferred tax free each year property worth more than $1 million to their children and other close relatives (585 F.2d at 235).[27]

---

[26] See, *e.g.*, Bettner, *Interest-Free Loan to Poorer Relations Can Cut Income Taxes if He Invests Money in His Name*, Wall St. J., Dec. 20, 1982, at 42, col. 1; Thater & Richey, *An Overview of Cases Dealing with Interest-Free Loans*, 121 Tr. & Est. 35 (Dec. 1982); Note, *Interest-Free Loans: Opportunities for Tax Planning*, 65 A.B.A. J. 634, 636 (1979); Edwards, *What Planning Opportunities Does CA-7's No-Gift—Tax Holding in Crown Open Up?*, 50 J. Tax'n 168, 170 (1979); Aslanides & McGowan, *Interest-Free Loans Get Green Light as Compensation and Estate Planning Devices*, 21 Tax. Acct. 260, 264-265 (1978); Taicher, *How to Use Interest-Free Loans in Family Tax Planning*, 11 Prac. Acct. 24, 27-28 (Sept. 1978); Tidwell, *Lester Crown Points the Way to Estate Tax Reduction Under the 1976 Tax Reform Act*, 55 Taxes 651 (1977); Burke, *Interest-Free Loans—A Valuable Family Tax Planning Tool?*, 48 Taxes 137 (1970); Seidman & Stuetzer, *Tax Clinic*, 120 J. Acct. 75 (1965).

[27] Although the *Crown* court recognized that imposing a gift tax on interest-free loans would protect the income tax (see note 25, *supra*), it did not agree that the estate tax would also be protected. The Seventh Circuit reasoned that, had the taxpayer not made the loans, he would be under no duty to invest that money, and consequently the loans could only reduce his *potential* estate (*i.e.*, the interest he might have earned), rather than his actual estate (since the full principal amount of the loans would, the court reasoned, be included in his estate). The court denied "that the congressional purpose

In addition, a holding that the instant loans do not result in taxable gifts would substantially undercut the grantor trust income tax provisions. If the settlor of a trust retains significant rights in or powers over the corpus of the trust, the 1954 Code treats him as the owner of the trust and he is taxable on any

---

of protecting the estate tax was concerned with the use of gifts to diminish a taxpayer's potential estate as well as his actual one" (585 F.2d at 237). See also *Crown*, *supra*, 67 T.C. at 1063-1064; *Johnson*, *supra*, 254 F. Supp. at 77. But Congress clearly *was* concerned with transactions that would reduce potential estate taxes (H.R. Rep. No. 708, *supra*, at 28; S. Rep. No. 665, *supra*, at 40; 65 Cong. Rec. 3119-3120 (1924) (purpose of statute is "to impose a tax which measurably approaches the estate tax which would have been payable on the donor's death had the gifts not been made and the property given had constituted his estate at his death")). Just as a gratuitous transfer of income-producing property enables the taxpayer to escape income tax liability on the future income that property would generate, such a transfer also enables the taxpayer to avoid the future estate tax liability that would result from the earnings generated by that property which would ultimately become part of his estate.

In any event, the Seventh Circuit was wrong in its assumption that making an interest-free demand loan does not reduce a taxpayer's "actual" estate. In fact, it probably will do so, since any outstanding notes will be worth less than face value. The right to receive repayment of a loan is worth less than the face amount of the loan. No one would pay $1,000 for the right to demand payment from another person of $1,000; there would have to be some discount for the delay, however short, in repayment, as well as for the risk of noncollectibility. Although that discount might be very little, it could also be substantial where the borrower's ability to repay was in great doubt. See Rev. Rul. 81-286, 1981-2 Cum. Bull. 177, 178.

Finally, even if it were assumed that protection of the estate tax is not furthered by taxing interest-free loans, the protection of the income tax alone would be sufficient to justify application of the gift tax to such loans.

income earned by the trust. See 26 U.S.C. 671. See also *Helvering* v. *Clifford*, 309 U.S. 331 (1940). In order to avoid taxability on a trust's income, the settlor must create a trust of at least 10 years' duration (26 U.S.C. 673), and must comply with the other safeguards against retained powers or interests contained in 26 U.S.C. 674-677. These safeguards would be unavailing if a taxpayer could, without gift tax liability, avoid the trust requirements merely by making a demand loan to the desired beneficiary. The taxpayer could then call the loan at any time, while the beneficiary could meanwhile invest the funds in income-producing assets, on which income he, not the lender, would be taxed.

III. THE HOLDING BELOW IS CONSISTENT WITH DECISIONAL LAW CONCERNING RELATED SITUATIONS

A. Term Loans

The Tax Court has recognized that a taxpayer who makes a term loan at below market interest rates confers a taxable gift equal to the difference between the amount lent and the fair market value of the promissory note received in exchange.[28] *Berkman* v. *Commissioner*, 38 T.C.M. (CCH) 183, 186 (1979); cf. *Blackburn* v. *Commissioner*, 20 T.C. 204 (1953) (sale of property for low interest promissory note results in taxable gift in amount of discount). Indeed, the Seventh Circuit has itself recognized the same principle, holding in *Mason* v. *United States*, 513 F.2d 25

[28] Because a term note bearing a below market interest rate has a market value of less than its face amount, a loan evidenced by a note for the amount borrowed at a below market interest rate does not represent an equal exchange of value, and accordingly results in a gift taxable under the Internal Revenue Code of 1954, 26 U.S.C. (Supp. V) 2512(b).

(1975), that such a transfer gives rise to a deduction for a charitable contribution.

Precisely the same principles apply when the loan is not for a set term and the interest rate is reduced to nothing. In the case of a below market, or interest-free, term loan, there is an immediate gift of the right to use the money for the predetermined period, whereas in the demand loan situation there is an on-going gift of the right to use the money for as long as the lender allows.[29] But this difference relates only

---

[29] Petitioners contend that this view of a demand loan "is at war with the ordinary concept of the term 'transfer,' " which in their view "connotes a discrete, affirmative act whereby a person conveys something to another person, not a continuous series of minute failures to require return of something loaned" (Br. 22). Petitioners also point (*id.* at 20, 22) to the reference in 26 U.S.C. 2512(a) to "the date of the gift." Petitioners ignore the fact that there undeniably is a transfer of property in these situations. Moreover, the regulations specifically contemplate gifts occurring over a period of time. See 26 C.F.R. 25.2511-2(f) (where there is an incomplete gift in trust, receipt by the beneficiary of the enjoyment of the transfered property "constitutes a gift * * * as of the calendar quarter or calendar year of its receipt"). In sum, when borrowers like Lyle and Artesian are given, for a period of several years, the right to use hundreds of thousands of dollars, they have received a gift. The fact that this gift is accomplished by the failure to call for repayment of demand loans, instead of by some other method (such as a term loan or gift of money to pay interest to a bank) can make no difference in light of Congress's express intent that the gift tax "cover and comprehend all transactions * * * whereby * * * property or a property right is donatively passed to or conferred upon another, regardless of the means or the device employed in its accomplishment" (H.R. Rep. No. 708, *supra*, at 27-28; S. Rep. No. 665, *supra*, at 39).

The *Crown* court acknowledged that the gift could be viewed as "occurring continuously during the period that the loan is

to the valuation of the gift; it does not justify disparate tax treatment of the gift itself.[30]

Indeed, any distinction between term and demand loans in close family situations such as the present

---

outstanding" (585 F.2d at 240); it nevertheless concluded that (*ibid.*; footnote omitted)—

> To characterize the mere use of property as a transfer of a property right implies a broader concept of what constitutes a property right under the gift tax laws than has heretofore been recognized.

The court, however, failed to recognize that the transfer before it was not simply of the use of the money, but rather a transfer of the right to use the money. The right to use property (including money) "on demand" clearly is itself "property," the value of which depends on the length of time the donee is given that right (see pages 17-19, *supra*).

[30] The conclusion that interest-free loans, whether term or demand, result in taxable gifts has received strong support from the commentators. See, *e.g.*, S. Surrey, W. Warren, P. McDaniel & H. Gutman, *Federal Wealth Transfer Taxation: Cases and Materials* 154-156 (2d ed. 1982); R. Stephens, G. Maxfield, S. Lind & D. Calfee, *Federal Estate and Gift Taxation* ¶ 10.01[2][f] (5th ed. 1983); H. Dubroff & D. Kahn, *Federal Taxation of Estates, Gifts and Trusts* ¶ 20-02, at 314 (3d ed. 1980); Joyce & Del Cotto, *Interest-Free Loans: The Odyssey of a Misnomer*, 35 Tax L. Rev. 459, 468-469, 489-490 (1980); Pulliam, *Income and Gift Tax Implications of Nonbusiness Interest-Free Loans: Looking a Gift Horse in the Mouth*, 58 Taxes 675 (1980); Carey, *Interest-Free Loans and the Gift Tax: Crown v. Commissioner*, 38 Ohio St. L.J. 903, 907-916 (1977); O'Hare, *The Taxation of Interest-Free Loans*, 27 Vand. L. Rev. 1085, 1088 (1974); *Recent Development—Gift Taxes—Interest-Free Demand Loans Are Not Taxable Gifts—Johnson v. United States*, 65 Mich. L. Rev. 1014 (1967); Westover, *Gift Taxation of Interest-Free Loans*, 19 Stan. L. Rev. 870 (1967); Note, *The Value of the Use of Money Loaned by Taxpayers to their Children Without Interest Does Not Constitute a Gift*, 5 Hous. L. Rev. 138 (1967).

case is largely artificial; demand loans made in such circumstances are not necessarily comparable to arm's-length demand loans, and may have characteristics resembling outright gifts of money. For example, where a bank makes a demand loan, it might be expected to demand repayment if the borrower's financial position deteriorates. In contrast, when a father makes a demand loan to his child and the child's financial position worsens, the father is *less* likely to demand repayment. Indeed, the father might even forgive the loan or make additional loans.[31] In family situations demand for repayment would thus generally be made, not when an unrelated creditor might do so, but rather at such time as the borrower has sufficient funds to repay the loan. In fact, the testimony as to the loans to Artesian was precisely to this effect (Tr. 23), and the Tax Court found that demand for repayment would be made "when it was financially beneficial [to Artesian] to do so" (Pet. App. 23a).[32]

The reality of such demand loans is accordingly that they are typically made with the intent that repayment will be made only when the debtor has suffi-

---

[31] Compare the limitation on the deduction of nonbusiness bad debts contained in 26 U.S.C. (& Supp. V) 166(d), which was enacted to curb abuses where taxpayers claimed bad debt deductions on intra-family "loans" where there was in fact no expectation of repayment. See H.R. Rep. No. 2333, 77th Cong., 2d Sess. 45 (1942). See also *Putnam* v. *Commissioner*, 352 U.S. 82, 91 (1956).

[32] Compare the following finding in *Johnson*, *supra*, 254 F. Supp. at 76, involving intra-family interest-free demand loans made over an eight-year period:

> No demand was made by taxpayers of the debtors for repayment, and the repayments as reflected by the [stipulated] facts were voluntary rather than forced payments.

cient funds available, if in fact there is any intent to seek repayment at all. Thus, these loans are usually made for indefinite, extended periods.[33] Indeed, here

---

[33] If the parties to a demand loan do not in fact contemplate that the borrower will have the use of the money for an extended period of time, then a gift of the entire principal amount of the loan may result if demand for repayment is not made within a few years of the date of the loan. See *Estate of Lang* v. *Commissioner*, 613 F.2d 770, 772-774 (9th Cir. 1980) (taxable gift occurred where mother permitted three-year statute of limitations to expire on interest-free demand notes); Rev. Rul. 81-264, 1981-2 Cum. Bull. 186. In many jurisdictions the statute of limitations for bringing suit on a demand note begins to run from the date of the note. See, *e.g.*, *Estate of Lang*, *supra*, (State of Washington); *Schnug* v. *Schnug*, 203 Kan. 380, 454 P.2d 474 (1969); U.C.C. § 3-122(1)(a). However, "where an agreement for payment of money contemplates an indefinite delay in payment, the statute of limitations does not begin to run until the actual demand has been made." *Cochran* v. *Cochran*, 133 Wash. 415, 419, 233 P. 918, 920 (1925). See also *Barer* v. *Goldberg*, 20 Wash. App. 472, 475, 582 P.2d 868, 871 (1978); *Vermilyea* v. *Vermilyea*, 61 Cal. App. 608, 215 P. 686 (1923). Florida law, which presumably would govern the instant loans, currently provides that the statute of limitations on demand notes begins to run only upon written demand for payment. Fla. Stat. Ann. § 95.281 (West. 1982) (formerly § 95.031(1)); Fla. Stat. Ann. § 673.3-122(2) (West 1966 & Cum. Supp. 1983). See *Ruhl* v. *Perry*, 390 So. 2d 353, 356 (Fla. 1980). Thus, since demand for payment was not made on the loans to Lyle represented by notes, it would appear that the statute of limitations for suit on those notes did not begin to run during the periods involved here. See *Ruhl* v. *Perry*, *supra*. On the other hand, the $65,000 loan to Lyle made on open account on June 30, 1975 (Stip. of Facts ¶ 12) may have resulted in a taxable gift in its principal amount if it were still outstanding when the four-year statute of limitations for suit on oral contracts expired after the taxable periods here in issue. Fla. Stat. Ann. § 95.11(k) (West 1982). See *Stoudenmire* v. *Florida Loan Co.*, 117 So. 2d 500 (Fla. Dist. Ct. App. 1960).

the $144,715.87 lent Lyle by Paul in 1963 and the $166,130.05 lent Lyle by Esther in 1964 remained outstanding through the end of 1976 (see JX 49-AW). Such "demand" loans thus are more accurately characterized as indefinite term loans.

It is true that the timing of the gift, and thus its valuation, is different when a demand loan rather than a term loan is involved. But the valuation of the gift that occurs over the period when a demand loan is outstanding presents no serious difficulties.[34] In the case of a term loan, the borrower is granted the right to use the money for a predetermined period, and therefore there is an immediate gift of the fair market value of that right. In contrast, where a lender makes a demand loan, he makes a continuing transfer of the right to use property until such time as he demands its repayment. Thus, a demand loan results in an ongoing gift equal in amount to the fair market value of the right to use the money lent for the taxable periods during which the lender permits the borrower to use the money. Rev. Rul. 73-61, *supra*.

The Treasury Regulations provide that the value of property for gift tax purposes is "the price at which such property would change hands between a willing buyer and a willing seller, neither being under any compulsion to buy or to sell, and both having rea-

[34] The *Crown* court believed "the imputation of interest in subsequent time periods is seriously deficient as a measure of * * * value as of the time of the loan" (585 F.2d at 239). But this erroneously assumes that the entire gift took place the instant the loan was made. In fact, the gift is the ongoing right to use the money transferred for the period during which the lender refrains from demanding repayment, and therefore the correct method of valuing the transfer is by reference to the taxable periods during which the loan remains outstanding.

sonable knowledge of relevant facts." 26 C.F.R. 25.2512-1. In determining the value of a demand or term loan, one must first determine what interest rate would be charged on a comparable loan in an arm's length transaction.[35] The amount of the gift resulting then can readily be determined by accepted valuation methods, using a table set forth in the Gift Tax Regulations. Assuming a 10-year, interest-free term loan of $100,000 and assuming that an appropriate arm's length interest rate for such a loan would be 6%, the value of the loan would be equal to the present discounted value of the right to receive 6% interest on $100,000 for a period of ten years. Under 26 C.F.R. 25.2512-9(f), Table B, col. 3, this would be equal to $100,000 x .441605, or $44,160.50.[36] In contrast, the amount of the gift resulting from an interest-free

---

[35] The Commissioner here determined the proper interest rate by reference to certain rates prescribed by statute, which are tied to the prime rate. See note 6, *supra*. Those rates were not shown by petitioners to be excessive. Indeed, the rates selected probably underestimated the rates that would have been charged in an arm's length transaction, since it is unlikely that Lyle and Artesian could have borrowed at the prime rate. In any event, it was incumbent on petitioners, if they disagreed with the posited rates, to come forward with proof of more appropriate rates. Although petitioners and Amici urge that the Commissioner has proposed different rates of interest in different cases, none of these cases has ever reached the valuation stage. We note also that the prime rate has varied substantially over the periods involved in the cases. See H.R. Doc. No. 97-123, *supra*, Table B-67, at 310.

[36] This amount also is equal to the difference between the amount transferred ($100,000) and the value of the term note which the lender receives in exchange. That note, which represents the right to receive $100,000 in 10 years but without interest, has a present discounted value (assuming an appropriate interest rate for interest-bearing notes would be 6%)

demand loan would depend on the length of time during each taxable period that the loan remained outstanding. Assuming an appropriate annual interest rate of 6%, an interest free demand loan of $100,000 would result in an annual gift of $100,000 x .06 or $6,000.

B. Income Tax

The Seventh Circuit in *Crown*, as well as the Tax Court, referred to a series of cases beginning with *Dean* v. *Commissioner*, 35 T.C. 1083 (1961), non acq., 1973-1 Cum. Bull. 4, holding that interest-free loans in non-gift settings (*i.e.*, between corporation and shareholder or employer and employee) do not result in taxable income to the borrower (67 T.C. at 1063, 1064; 585 F.2d at 240).[37] But, as the court below observed (Pet. App. 12a n.8), those cases do not present the question of the gift taxation of transactions between family members. Although interest-free loans may occur both in intra-family and corporation/shareholder (or employer/employee) situations, it

---

of $100,000 x .558395 or $55,839.50. See 26 C.F.R. 25.2512-9(f), Table B, col. 4.

[37] See *Parks* v. *Commissioner*, 686 F.2d 408 (6th Cir. 1982), aff'g 40 T.C.M. (CCH) 1228 (1980); *Baker* v. *Commissioner*, 677 F.2d 11 (2d Cir. 1982), aff'g 75 T.C. 166 (1980); *Commissioner* v. *Greenspun*, 670 F.2d 123 (9th Cir. 1982), aff'g 72 T.C. 931 (1979); *Beaton* v. *Commissioner*, 664 F.2d 315 (1st Cir. 1981), aff'g 40 T.C.M. (CCH) 1324 (1980); *Martin* v. *Commissioner*, 649 F.2d 1133 (5th Cir. 1981), aff'g 39 T.C.M. (CCH) 531 (1979), also aff'g *Zager* v. *Commissioner*, 72 T.C. 1009 (1979) and *Creel* v. *Commissioner*, 72 T.C. 1173 (1979); *Suttle* v. *Commissioner*, 625 F.2d 1127 (4th Cir. 1980); *Trowbridge* v. *Commissioner*, 41 T.C.M. (CCH) 1302 (1981). See also *Joseph Lupowitz Sons, Inc.* v. *Commissioner*, 497 F.2d 862, 868 (3d Cir. 1974); *Saunders* v. *United States*, 294 F. Supp. 1276 (Hawaii 1968), rev'd on other grounds, 450 F.2d 1047 (9th Cir. 1971).

would ordinarily be only in the former situation that there could be a taxable gift.[38] An interest-free loan between a corporation and a shareholder or between an employer and an employee would almost always be a business transaction, and therefore would not have any gift tax consequences. See *Wemyss*, *supra*, 324 U.S. at 306. See also 26 C.F.R. 25.2511-1(g)(1), 25.2512-8. Accordingly, any tax consequences of such transactions would be income tax consequences, and thus have no relevance here.[39]

In any event, the *Dean* line of cases is based on a rationale that is peculiar to the income tax and has no application to the gift tax. The court below expressed this rationale as follows: "If the receipt of an interest free loan [in a non-gift setting] is taxed [as income] because it is the equivalent of the payment of additional income by which to obtain the loan (*i.e.*, with which to pay interest), then a deduction based on the payment would also be available."

---

[38] Indeed, corporations as such are not subject to the gift tax; a gift by a corporation is treated as a pro rata gift by its shareholders. See 26 C.F.R. 25.2511-1(h)(1).

[39] Compare the definition of "gift" for gift tax purposes in *Commissioner* v. *Wemyss*, *supra*, 324 U.S. at 306-307 (donative intent is irrelevant; gift results from any transfer "not made in the ordinary course of business * * * to the extent that it is not made 'for an adequate and full consideration in money or money's worth' ") with the definition of "gift" for income tax purposes (see 26 U.S.C. 102) in *Commissioner* v. *Duberstein*, 363 U.S. 278, 285 (1960) (gift requires a " 'detached and disinterested generosity,' " quoting *Commissioner* v. *LoBue*, 351 U.S. 243, 246, (1956)). See also *Commissioner* v. *Beck's Estate*, 129 F.2d 243, 246 (2d Cir. 1942) ("Perhaps to assuage the feelings and aid the understanding of affected taxpayers, Congress might use different symbols to describe the taxable conduct in the several statutes, calling it a 'gift' in the gift tax law, a 'gaft' in the income tax law, and a 'geft' in the estate tax law.").

Thus, the courts have reasoned in these cases that any additional income to the borrower would be exactly offset by a deduction for interest paid under 26 U.S.C. 163, so that there would be a complete "wash." See, *e.g.*, *Parks* v. *Commissioner*, 686 F.2d 408 (6th Cir. 1982); *Baker* v. *Commissioner*, 677 F.2d 11 (2d Cir. 1982); *Commissioner* v. *Greenspun*, 670 F.2d 123, 125 (9th Cir. 1982); *Dean*, *supra*, 35 T.C. at 1090.[40] It is the government's position that

[40] In *Hardee* v. *United States*, No. 84-79 (Fed. Cir. May 11, 1983), reh'g denied (July 6, 1983), rev'g No. 84-79T (Ct. Cl. July 6, 1982), a shareholder who received interest-free loans from a corporation apparently used the loan proceeds to acquire tax exempt municipal bonds. Had the shareholder paid interest on those loans, he would not have been able to deduct that interest by virtue of 26 U.S.C. (Supp. V) 265(2), which denies deductions for, *inter alia*, "[i]nterest on indebtedness incurred or continued to purchase or carry obligations the interest on which is wholly exempt from" income tax. The Claims Court accepted the government's argument that *Dean* was wrongly decided and held that the taxpayer had received taxable income. The Federal Circuit reversed, holding that "the definition of taxable income was never intended to encompass the free, temporary use of corporate money by a majority shareholder officer" (*Hardee*, *supra*, slip op. 10), and concluding that it was immaterial whether the shareholder would have been denied a deduction for interest under 26 U.S.C. (Supp. V) 265(2) had he paid interest for the borrowed funds. This holding is contrary to *Glenshaw Glass Co.*, *supra*, where this Court stated that Congress exerted " 'the full measure of its taxing power' " in enacting the income tax (348 U.S. at 429, quoting *Helvering* v. *Clifford*, *supra*, 309 U.S. at 334) and that it was the "intention of Congress to tax all gains except those specifically exempted" (348 U.S. at 430). The holding in *Hardee* also is contrary to many decisions holding that shareholder use of corporate property results in taxable income. See, *e.g.*, *Gardner* v. *Commissioner*, 613 F.2d 160 (6th Cir. 1980) (automobile); *Chandler* v. *Commissioner*, 119 F.2d 623 (3d Cir. 1941) (residence); *Challenge Manufacturing Co.* v. *Commissioner*, 37 T.C. 650 (1962)

those cases were wrongly decided.[41] But, in any event, since in the gift tax context there is no offsetting de-

---

(boat); *Frueauff* v. *Commissioner*, 30 B.T.A. 449 (1934) (apartment).

The majority's statement in *Hardee* that the *Dean* line of cases was not based on the rationale that the borrower would be entitled to an offsetting deduction is factually wrong, as Judge Kashiwa noted in his dissent (*Hardee, supra*, slip op. 15-10). The Tax Court in *Dean* specifically distinguished the cases holding that personal use of corporate property results in income as follows (35 T.C. at 1090; footnote omitted):

> [H]ad petitioners borrowed the funds in question on interest-bearing notes, their payment of interest would have been fully deductible by them under section 163, I.R.C. 1954. Not only would they not be charged with the additional income in controversy herein, but they would have a deduction equal to that very amount. We think this circumstance differentiates the various cases relied upon by the Commissioner * * *.

Indeed, the courts following *Dean* have explicitly stated that their holdings turned on the offsetting deduction for interest paid. See *Parks, supra*, 686 F.2d at 409; *Baker, supra*, 677 F.2d at 11; *Greenspun, supra*, 670 F.2d at 125, 72 T.C. at 947 ("In holding that no income was realized by the taxpayers in *Dean*, however, we reasoned that had the taxpayers borrowed the funds on interest-bearing notes, their payment of interest would have been fully deductible under section 163."); *Beaton, supra*, 664 F.2d at 316-317; *Martin, supra*, 649 F.2d at 1133-1134; *Suttle, supra*, 625 F.2d at 1128.

[41] The assumption in those cases that whether an item is includible in income under 26 U.S.C. 61 depends on whether an offsetting deduction is available is simply wrong. In addition, the courts' assumption that there would be an offsetting deduction available for interest (neither charged, paid, nor accrued) is patently erroneous. Section 163 of the 1954 Code permits a deduction for interest paid or accrued, and since no interest was in fact paid or accrued, no deduction would be available. The hypothetical "offsetting deduction" is exactly that—hypothetical.

duction against the amount of the gift to which the lenders would be entitled, those cases, even if correct, would offer no support to the petitioners (see Pet. App. 13a n.8).

To the contrary, those cases in fact support the result below, since they reason that the tax consequences of an interest-free demand loan should be the same as the case of an interest-bearing loan accompanied by a transfer of additional money that the borrower uses to pay the interest on the loan (see, *e.g.*, *Greenspun*, *supra*, 72 T.C. at 947-948). Had the Dickmans made interest-bearing loans to Lyle and Artesian, and then given them money to pay the interest on those loans, there could be no doubt that the additional money would constitute taxable gifts to the borrowers (Pet. App. 12a-13a n.8).[42]

---

[42] Petitioners (Br. 38-42) seek support in cases where the government argued that a portion of the payments received in interest-free installment sales should be treated as interest and not as sales proceeds, and also in cases where the government sought to treat the lender of money at a less than arm's length rate of interest as having realized additional interest income. Petitioners note that the courts rejected the Commissioner's claims in those cases and Congress responded with specific statutes, *i.e.*, 26 U.S.C., (& Supp. V) 483 (providing for recharacterization of certain installment sales proceeds as constituting unstated interest) and 26 U.S.C. 482 (providing for reallocation of income and deductions between commonly controlled businesses). Those cases, and those statutes, are not relevant here. The court below did not recharacterize sales proceeds as something else, nor did it allocate income in any sense. Rather, the court simply held that, since the borrowers here were given property for which they paid no consideration, taxable gifts resulted.

IV. THE HOLDING BELOW CREATES NEITHER ADMINISTRATIVE PROBLEMS NOR ANOMALIES IN THE TAX LAWS

A. Insignificant Loans

The Tax Court and the Seventh Circuit in *Crown* were concerned that the Commissioner's view of the tax consequences of interest-free loans would lead to IRS involvement in "a multitude of situations involving gratuitous use or sharing of real or personal property among relatives" (67 T.C. at 1065) and friends (585 F.2d at 241). These perceived administrative problems are largely if not entirely illusory, because the gift tax exclusion and credit provisions will cover virtually all such transfers. Section 2503 (b) of the 1954 Code (26 U.S.C. (Supp. V)) now provides that a taxpayer may annually give up to $10,000 to each of any number of persons without incurring any gift tax liability.[43] In addition, should a taxpayer make a gift during one year worth more than $10,000 to any one person, the taxpayer would not incur any gift tax liability until he has exhausted his credit under 26 U.S.C. (& Supp. V) 2505 (which replaces the $30,000 lifetime exemption under former 26 U.S.C. 2521, applicable in the taxable periods involved in this case). For gifts made in 1983, the tax credit under Section 2505 is $79,300, which is equivalent to a lifetime exemption for gifts of a value of $275,000. (Under the Economic Recovery Tax Act of 1981, this credit is increased each year to 1987,

[43] In the taxable periods involved in this case, Section 2503(b) provided for an annual exclusion of $3,000 per donee. Effective for transfers after December 31, 1981, the annual exclusion under Section 2503(b) was raised to $10,000. See the Economic Recovery Tax Act of 1981, Pub. L. No. 97-34, Section 441(a), 95 Stat. 319.

when it will be $192,800, equivalent to a lifetime exemption for gifts worth $600,000.[44]) Thus, for a taxpayer today to incur a gift tax liability (assuming he has available his full credit under Section 2505), he would have to make a gift to one person during one year of more than $285,000 ($275,000 plus $10,000). A taxpayer would have to confer an interest-free demand loan for the entire year of more than $1,425,000 to result in such a gift (assuming an arm's length interest rate of 20%).[45] Clearly, lending a neighbor one's lawnmower or one's automobile or putting up guests for a night (see *Crown*, *supra*, 585 F.2d at

---

[44] See 26 U.S.C. 2505, as amended by the Economic Recovery Act of 1981, Pub. L. No. 97-34, Section 401(b), 95 Stat. 299.

[45] Other statutory provisions may apply so as to limit further the application of the gift tax to substantial transfers. For example, under 26 U.S.C. (Supp. V) 2513(a) an election may be made to treat a gift in fact made by one spouse as made half by each spouse. Each spouse could then apply a separate $10,000 exclusion and gift tax credit to the portion of the gift he or she is deemed to have made. Thus, if married taxpayers had available their full credits under Section 2505, their election under Section 2513(a) to "split" the gift would permit them to loan on demand $2,850,000 in one year to one person (assuming a 20% interest rate) without incurring gift tax liability.

In addition, new 26 U.S.C. (Supp. V) 2503(e), added by Section 441(b) of the Economic Recovery Tax Act of 1981, Pub. L. No. 97-34, 95 Stat. 319, excludes from taxable gifts any amount paid on behalf of an individual (1) as tuition at a qualified educational institution and (2) for medical care, so that any such payments would not deplete a taxpayer's Section 2505 credit. Finally, expenditures to discharges one's legal obligation to support one's family have traditionally been viewed as not subject to the gift tax. R. Stephens, G. Maxfield, S. Lind & D. Calfee, *supra*, at ¶ 10.02[5]; *cf. Harris v. Commissioner*, 340 U.S. 106 (1950).

241) would not subject the ordinary taxpayer to any gift tax. While it is true that a taxpayer who has exhausted his Section 2505 credit would be subject to tax if he makes an interest-free loan to a donee (to whom he has already given $10,000 that year), he would also be subject to tax on any additional gift of cash or other property, however insignificant its value, to that same donee.[46]

---

[46] Amicus D'Ancona & Pflaum asserts that "[f]ew people file gift tax returns every year," and contends that, because there is no statute of limitations for assessment of gift taxes where no return is filed, "affirmance of the decision below may apply to gift tax periods all the way back to 1932" (Br. 3). Although Amicus is correct that the average person does not file gift tax returns, persons who were sufficiently wealthy to be able to make interest-free loans that would be subject to the gift tax would very likely have been required to file returns anyway because of other gifts they made, not involving loans. Consequently, if those individuals filed returns, as they were required to do, assessment of any additional tax liability would be barred by the applicable statute of limitations. See, *e.g.*, Revenue Act of 1932, ch. 209, Section 517(a), 47 Stat. 254 (3 year statute of limitations on assessment of gift tax liability).

The gift tax has always included a provision permitting taxpayers to make substantial gifts to an unlimited number of persons each year without resulting in a gift tax liability. This exclusion was $5,000 for gifts made from 1932 through 1938 (Revenue Act of 1932, ch. 209, Section 504(b), 47 Stat. 247); $4,000 for gifts made from 1939 through 1942 (Revenue Act of 1938, ch. 289, Section 505, 52 Stat. 565; Internal Revenue Code of 1939, ch. 2, Section 1003(b), 53 Stat. 146); $3,000 for gifts made from 1943 through 1981 (Revenue Act of 1942, ch. 619, Section 454, 56 Stat. 953; Internal Revenue Code of 1954, ch. 736, Section 2503(b), 68A Stat. 404); and $10,000 for gifts made after 1981 (Economic Recovery Tax Act of 1981, Pub. L. No. 97-34, Section 441(a), 95 Stat. 319). In addition, the gift tax always has included a substantial "lifetime exemption" (now a credit) applicable to the total amount of gifts made by resident taxpayers. This exemption was $50,000 from

B. Valuation

The Seventh Circuit (*Crown*, *supra*, 585 F.2d at 240-241) and petitioners (Br. 34) also assert that the valuation of the gift resulting from an interest-free loan poses substantial administrative and judicial problems. But it should be relatively easy to determine the appropriate interest rate for a loan with a reasonable degree of accuracy as, for example, through the testimony of a bank officer who is familiar with prevailing interest rates. An interest-free demand loan presents no greater valuation problems than does an interest-free or low interest term note, which the courts have regularly valued without difficulty (see *Berkman* v. *Commissioner*, *supra*; *Blackburn* v. *Commissioner*, *supra*; *Mason* v. *United States*, *supra*). Indeed, the courts routinely value property interests that are vastly more difficult to evaluate than the interests involved here. See, *e.g.*, *Wallace* v. *United States*, 82-1 U.S. Tax Cas. (CCH) ¶ 13,442 (Mass. 1981) (nonvoting common stock in closely held corporation); *Smith* v. *Commissioner*, 41 T.C.M. (CCH)

1932 through 1935 (Revenue Act of 1932, ch. 209, Section 505(a)(1), 47 Stat. 247); $40,000 from 1936 through 1941 (Revenue Act of 1935, ch. 829, Section 301(b), 49 Stat. 1025; Internal Revenue Code of 1939, ch. 2, Section 1004(a)(1), 53 Stat. 147); and $30,000 from 1942 through 1976 (Revenue Act of 1942, ch. 619, Section 455, 56 Stat. 953; Internal Revenue Code of 1954, ch. 736, Section 2521, 68A Stat. 410). In 1976 the lifetime exemption was converted to a credit. See 26 U.S.C. (Supp. V) 2505. Thus, for a taxpayer to have incurred a gift tax liability in 1932, for example, he would first have had to have exhausted his lifetime exemption of $50,000 and, in addition, have given more than $5,000 to one person. For an interest-free demand loan to result in a gift of $5,000, even assuming an interest rate of 3%, a taxpayer would have had to have lent more than $166,000 to one person for a full year.

1427 (1981) (patents for a liquid propulsion system); *Webster Investors, Inc.* v. *Commissioner*, 19 T.C.M. (CCH) 396 (1960) (brand name).[47] But even if it were difficult to value the instant gifts, that would not affect their taxability. As this Court stated in *Smith* v. *Shaughnessy*, *supra*, 318 U.S. at 180:

> Even though these concepts of property and value may be slippery and elusive they can not escape taxation so long as they are used in the world of business. The language of the gift tax statute, 'property * * * real or personal, tangible or intangible,' is broad enough to include property, however conceptual or contingent.

See also *Galt* v. *Commissioner*, 216 F.2d 41, 50 (7th Cir. 1954), cert. denied, 348 U.S. 951 (1955).

---

[47] The valuation problems in cases involving interest-free loans are no different from those involving tangible property, such as an automobile having an agreed fair market value of $10,000. If the taxpayer transfers the car to his son in consideration for the son's promise to return the car, or an identical car, to the taxpayer one year later, there is a gift of the right to use the car for one year. An officer of an automobile rental company could testify as to the amount of one year's rental of the car, *i.e.*, as to the value of the gift. If the taxpayer transfers the car to his son in consideration for the son's promise to return the car, or an identical car, to the taxpayer upon demand, there is a gift of the right to use the car through the period prior to the taxpayer's demand for return. In this case also, an officer of an automobile rental agency could testify as to the value of the gift. If the property transferred from the taxpayer to the son is money rather than an automobile, and the son's undertakings with respect to retransfer are the equivalent of those above, the equivalent results would follow, except that an officer of a bank rather than an officer of an automobile rental agency should testify as to the value of the gift of the right to use the property lent.

C. Double Counting

Petitioners and amici contend that the decision below creates inconsistencies in the tax law. For example, Amicus Jones, Day alleges (Br. 18) that "the Commissioner is 'double counting' when he treats the borrower of an interest-free demand loan as the recipient of both a gift and of income on the borrowed funds." Amicus maintains, instead, that if the loans result in taxable gifts by the lenders, the borrowers should be able to exclude from their taxable income any interest they earn on the loans, "since this is precisely the benefit alleged to be received by gift" (*id.* at 16).

This argument is specious. Section 102 of the 1954 Code, which excludes from gross income "the value of property acquired by gift," specifically provides that the exclusion does not extend to "the income from any [such] property." Lyle and Artesian here received a gift of property (consisting of the right to use money) and requiring them to include in their incomes any earnings generated by that property no more results in "double counting" than does taxing any donee on the income from any property received as a gift, such as the rental income on a house received as a gift. Amicus' argument rests on the mischaracterization of the instant gifts as gifts of interest. In fact, the gifts here were not of interest, but rather of property rights, consisting of the right to use money, and the only relevance interest has is that the value of the property transferred is measured by reference to the interest rate that would be charged on a similar loan.[48] Indeed, the loans need

[48] The courts in *Crown, supra*, 585 F.2d at 236, 240, and *Johnson, supra*, 254 F. Supp. at 77, made a similar mistake in suggesting that the Commissioner was attempting to tax "im-

not even generate interest income to the borrowers. Although the borrowers might choose to deposit the loan proceeds in a bank and earn interest, they could as well use the loan proceeds to purchase stock or real estate, and it is clear that the earnings so generated (*e.g.*, dividends, rental income or capital gains) should be included in their income.

D. Loans Versus Outright Gifts

Amicus Jones, Day also observes (Br. 19-20) that "the gift tax on an amount lent to another can be greater than * * * the gift tax on the same amount *given outright*," and asserts that this results in double taxation and is senseless. To the contrary, however, this result is quite logical because of the "time value" of money.[49] The Seventh Circuit in *Crown* explained this alleged "paradox" as follows (585 F.2d at 239 n.14):

---

puted interest," and rejecting that attempt on the ground that taxpayers are under no legal obligation to charge such interest, especially to their children. There is, of course, no legal requirement that parents charge their children interest on loans; there is likewise no legal requirement that parents charge for any property they might choose to give their children. But the fact remains, if they do transfer property for less than full consideration, that is a taxable gift. The courts erroneously assumed that, for there to be a gift, the lender must forgive some obligation due him. Under that rationale, no gift of property would be taxable, since the government could be said to be attempting to impose a tax on an imputed payment for that property which the donor was, in fact, under no obligation to charge.

[49] The "time value" of money reflects the fact that "a dollar received at once is worth more than a dollar to be received at some date in the future." O'Hare, *The Taxation of Interest-Free Loans*, *supra*, 27 Vand. L. Rev. at 1088.

> [I]f a lender makes a $1,000 no-interest loan and the "proper" interest rate is 10% under the IRS formula he would be treated as having made a gift of $100 in each year the loan remains outstanding. Thus, if the loan remains outstanding for 20 years, he will be treated as having made gifts totaling $2,000, whereas he would only have been taxed on $1,000 if he had made a gift of the principal in the first place. However, the paradox is one of nominal rather than real values. In the case of the outright gift the tax is paid immediately, while under the loan the tax is paid at various points in the future. Because of the time-value of money, the present value of the two alternatives may be about the same.

Indeed the same "paradox" results in situations where even the Amicus would concede there are gifts. For example, suppose a house worth $100,000 would rent for $10,000 per year. If a taxpayer made an outright gift of the house, he would have made a taxable gift of $100,000, but if he made a series of gifts of rent-free term leases, after 20 years he would have made gifts totalling "twice" the house's value.

E. Loans to Charitable Organizations

Petitioners argue (Br. 6-7) that an interest-free loan to a charitable organization would result in the following "obviously unintended anomal[y]":

> An outright gift of money to charity would not be a taxable gift but would give rise to an income tax deduction, while an interest-free loan to that charity would be a taxable gift but no income tax deduction would be allowed.

See also *id.* at 30. But this result is in no way peculiar to interest-free loans; it occurs whenever a taxpayer transfers to a charity the cost-free right

to use any of his property. For example, if a taxpayer makes an outright gift of a building to a charity, he makes a taxable gift, but, in computing the gift tax, he has an offsetting deduction under 26 U.S.C. (& Supp. V) 2522(a), as well as a deduction (for purposes of income tax) under 26 U.S.C. 170. In contrast, if the taxpayer gives the charity a rent-free lease to the building, the fair rental value of the lease is a taxable gift, but the taxpayer is denied an offsetting deduction under 26 U.S.C. (& Supp. V) 2522(c), and also is denied any deduction for income tax purposes under 26 U.S.C. 170(f)(3). See 26 C.F.R. 1.170A-7(d), Examples (1) and (3). These tax consequences are mandated by the Code and reflect Congress's intent to remedy perceived abuses in the contribution to charities of certain partial interests in property.[50]

---

[50] Prior to the Tax Reform Act of 1969, courts held that a taxpayer could grant a charity the right to use the taxpayer's property rent free, and obtain a charitable deduction under 26 U.S.C. 170 for the fair market value of the right to use that property. See, *e.g.*, *Threlfall* v. *United States*, *supra*. This, however, resulted in a double benefit for the taxpayer, since courts also held that the taxpayer was not required to include in income the fair market rental value of the property. See *Threlfall*, *supra*, 302 F. Supp. at 1120. See also H.R. Rep. No. 91-413 (Pt. 1), 91st Cong., 1st Sess. 57-58 (1969); S. Rep. No. 91-552, 91st Cong., 1st Sess. 83 (1969). Congress eliminated this double benefit by enacting 26 U.S.C. 170(f)(3), which, in general, disallows deductions for income tax purposes for contributions of certain temporal interests in property. Because of additional perceived abuses in the gift tax area, Congress simultaneously amended Section 2522(c) to permit deductions for gift tax purposes for contributions of partial interests in property only where those interests meet certain strict requirements. See H.R. Rep. No. 91-413 (Pt. 1), *supra*, at 58-60; S. Rep. No. 91-552, *supra*, at 86-93.

In sum, the decision below is entirely consistent with generally applicable principles of the tax law and, as we have previously shown, is mandated by the pertinent statutory language and legislative history.

CONCLUSION

The judgment of the court of appeals should be affirmed.

Respectfully submitted.

REX E. LEE
Solicitor General

GLENN L. ARCHER, JR.
Assistant Attorney General

LAWRENCE G. WALLACE
Deputy Solicitor General

HARRIET S. SHAPIRO
Assistant to the Solicitor General

MICHAEL L. PAUP
JONATHAN S. COHEN
FARLEY P. KATZ
Attorneys

JULY 1983

☆ U. S. GOVERNMENT PRINTING OFFICE: 1983 411450 39